FROM CORPORATE GOVERNANCE TO SUSTAINABLE GOVERNANCE

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Abstract:
The subdued business environment is not fertile ground for experimenting on anything beyond core business functions. The core function of business is sound corporate governance, yet in recent years, the experience nationally and internationally is of the failure of current standards of corporate governance.

This has led to a revised agenda for corporate governance globally. Amongst the more progressive reviews are those that incorporate the notion of sustainable development. Yet for many, no mater how important environmental and social considerations are, the business world understands money better than anything else. The financial implications of any strategy are therefore critical. Without the confidence of shareholders and financial investors, a business cannot progress an agenda with broader environmental and social objectives.

A business that realises that risks that are not managed will have an economic impact with time have commenced this transition. A business financial performance can be enhanced or undermined by its reputation, brand equity, risk profile, innovation, productivity, efficiency, access to capital, licence to operate and ability to attract and retain talent.

Sustainable development and improved corporate governance will be the hallmarks of successful business in the 21st century. The term sustainable governance is emerging. As an ultimate objective, the concept of sustainable governance is immensely valuable. However, strategies are required to translate conceptual theories into practical reality. It is when sustainability principles are incorporated into the corporate governance agenda of a business that long-term shareholder value and success can be achieved and maintained.

In this paper, the application of sustainable governance in the Australian context is examined by the integration of the National Strategy for Ecologically Sustainable Development with the Australian Stock Exchange Principles for Corporate Governance. The resulting framework provides direction to those seeking progress towards an effective corporate sustainability agenda.

Executive Summary

"*There is growing acceptance of the view that organisations can create value by better managing natural, human, social and other forms of capital. Increasingly, the performance of companies is being scrutinised from a perspective that recognises these other forms of capital. That being the case, it is important for companies to demonstrate their commitment to appropriate corporate practices*." Australian Stock Exchange Corporate Governance Principle 10 (in part).

Accountability, **governance**, and **sustainability** are three powerful ideas that are playing a pivotal role in shaping how government, business and communities operate in the 21st century. Together, they reflect the emergence of a new level of societal expectations of government, business and communities to provide leadership for economic, environmental and social well-being.

This paper explores the principles of accountability, governance and sustainability and their integrated role in responsible leadership and performance.

Introduction

The principles of accountability, according to the Assurance Standard AA1000, are:

1. **Materiality**: The inclusion of information about Sustainability Performance required by Stakeholders for them to be able to make informed judgements, decisions and actions.
2. **Completeness**: The extent to which Sustainability Performance associated with activities, products, services, sites and subsidiaries, for which there are management and legal responsibility, is identified and understood.
3. **Responsiveness**: The response to specified Stakeholder concerns and interests, and providing adequate indicators of associated changes in Sustainability Performance.

The principles of governance, according to the Australian Stock Exchange, are:

1. Lay solid foundations for **management and oversight**
2. **Structure** the board to add value
3. Promote ethical and responsible **decision-making**
4. Safeguard **integrity** in financial **reporting**
5. Make **timely** and balanced disclosure
6. Respect the rights of **shareholders**
7. Recognise and manage **risk**
8. Encourage **enhanced performance**
9. **Remunerate** fairly and responsibly
10. Recognise the legitimate **interests of stakeholders**

The principles for sustainability performance, according to the Global Reporting Initiative, are:

1. **Transparency**: Full disclosure of the processes, procedures and assumptions in report preparation are essential to its credibility.
2. **Inclusiveness**: The reporting organisation should engage its stakeholders in preparing and enhancing the quality of reports.
3. **Auditability**: Reported information should be recorded, compiled, analysed and disclosed in a way that enables internal auditors or external assurance providers to attest to its reliability.
4. **Completeness**: All material information should appear in the report.
5. **Relevance**: Reporting organisations should use the degree of importance that report users assign to particular information in determining report content.
6. **Context**: Reporting organisations should seek to place their performance in the broader context of ecological, social or other issues where such context adds significant meaning to the reported information.
7. **Accuracy**: Reports should achieve a degree of exactness and low margin of error to enable users to make decisions with a high degree of confidence.
8. **Neutrality**: Reports should avoid bias in selection and presentation of information and provide a balanced account of performance.
9. **Comparability**: Reports should be framed so as to facilitate comparison to earlier reports as well as to reports of comparable organisations.
10. **Clarity**: Information should be presented in a manner that is understandable by a maximum number of users while still maintaining a suitable level of detail.
11. **Timeliness**: Reports should provide information on a regular schedule that meets user needs and comports with the nature of the information itself.

The Economic Case for Integration

No mater how important environmental and social considerations are, people understand money better than anything else. The financial implications of any strategy are therefore critical. Without the confidence of finances, shareholders and/or financial investors, government, business or the community cannot progress an agenda with broader environmental and social objectives.

Those that realise that risks that are not managed will have an economic impact with time have commenced an important transition. Financial performance can be enhanced or undermined by reputation, brand equity, risk profile, innovation, productivity, efficiency, access to capital, licence to operate and ability to attract and retain talent.

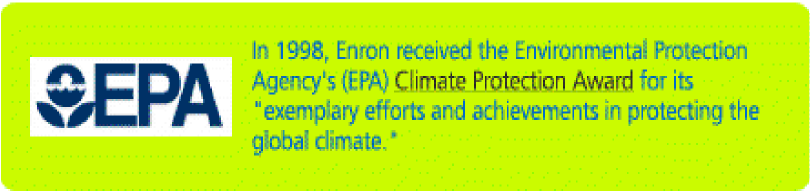
The economic processes of accountability, governance and sustainability are parallel agendas. **Why then would investors, as legal owners, look at the governance through the lens of sustainability?**

To illustrate the relationship between sustainability and governance in the economic context, we need to look no further than the inexorable, inconvenient, pervasive, disturbing, potentially cataclysmic problem of climate change. The facts are:

1. There is overwhelming scientific data that we, as well as nature, are influencing the climate of the planet.
2. These changes will have an intensifying impact on capital (economic, environmental and social) agendas.
3. Governance dictates that those who are responsible for preserving the value of these businesses and investments analyse this risk and take steps to mitigate those risks.

If governments, businesses and communities fail to be accountable for their role in the seriousness of embedded climate change, and the sustainability risks they raise, they fail profound questions about whether they are following the reasonable expectations of good governance.

(CNN, 2001) The accounting for a global trading company like Enron is mind numbingly complex. But it's crucial to learning how the company fell so far so fast, taking with it the jobs and pension savings of thousands of workers and inflicting losses on millions of individual investors. At the heart of Enron's demise was the creation of partnerships. These partnerships allowed Enron to keep hundreds of millions of dollars in debt off its books. But once stock analysts and financial journalists heard about these arrangements, investors began to lose confidence in the company's finances. The results: a run on the stock, lowered credit ratings and insolvency. (NOTE: In 1998, Enron received the EPA Climate Protection Award.)



The conclusion therefore is that accountable government, business and communities must recognise and respond to integrated sustainability issues to demonstrate good corporate governance.

The Ethical Case for Integration

If you value integrity, remember that you speak volumes by what you do not say. You expose your integrity by what you refuse to accept. You highlight your conviction by what you refuse to believe. Astute people will determine your fibre by observing what you deem insignificant. They will construe your essence by what you overlook. They will interpret your actions by what you neglect. They will assess your grandeur by how low you stoop. They will examine your honour by what you hide.

Of all the species, we humans seem to be the least co-ordinated. We amass wealth without purpose. We grow without reason. We consume without need. If you do not know what will satisfy you, you will never be satisfied with anything.

We need to develop and maintain an informed "social conscience" that will enable us to identify and resist structures of injustice and affirm accountability in society. This will especially be the case at the time of heightened political activity, for instance when a general election is in prospect, scrutinising an organisation's activities, products or services, or our stance as a local community when compared against the greater common good.

"If you are to suffer, you should suffer in the interest of the country." - Jawaharlal Nehru, speaking to villagers who were to be displaced by the Hirakud Dam, 1948.

The World Health Organization (WHO) estimates that worldwide, more than 25 million people are poisoned by pesticides every year. 1999, New York: *Fifteen years after thousands of people were killed in a poison gas leak at a Union Carbide pesticide factory in Bhopal, India, lawyers have filed a class action lawsuit in New York charging the corporation with violating the fundamental human rights of the victims and survivors of the disaster. The toxic gas killed at least 16,000 according to local estimates; tens of thousands continue to suffer. The suit has been filed under the Alien Tort Claims Act that provides for civil remedies for criminal violation of international law by U.S.-based corporations. The lawsuit alleges that Union Carbide "demonstrated a reckless and depraved indifference to human life in the design, operation and maintenance" of the Union Carbide facility in Bhopal. According to news reports, Union Carbide stated that it had not reviewed the suit but that "all personal injury and related claims ... were settled in 1989." At that time, the company paid US$470 million as part of an out-of-court settlement that granted company officials immunity from prosecution.*

The test therefore for governments, businesses and communities is whether it enhances or threatens human dignity and indeed human life itself. Policies and actions that treat people as only economic units, or policies which reduce people to a passive state of dependency on welfare, do not do justice to the dignity of the human person.

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The Environmental Case for Integration

We borrow the Earth from our descendants and need to be preserved for use by future generations.

Environmental issues, in there own right, have been a matter of public concern for over a quarter of a century. As knowledge about the causes and effects of environmental damage increased, a number of activities became identified as the major source of environmental pollution. In the late 70's and the 80's governmental initiatives dominated the agenda in the western economy. Laws were adopted and regulation implemented. This is also referred to as the command and control approach.

Environmental protection was mainly achieved through remediation when damages were revealed or end-of-pipe cleaning efforts in order to meet value limits for effluents and wastes.

> ***New York, N.Y.*** *December 2000: After a ten-year, exhaustive scientific study of the contamination of the Hudson River from polychlorinated biphenyls, or PCBs, U.S. EPA Administrator Carol Browner today announced a proposed plan to clean up the river and protect public health.* *The Hudson River is among America's great natural treasures,' said Browner. Today's proposal comes after ten years of extensive scientific study. This scientific assessment is the basis for today's action -- one of the most aggressive environmental efforts ever proposed to restore a contaminated river and protect the public's health. People who eat PCB-contaminated fish face an increased risk of cancer and other serious medical conditions including developmental, immune system, thyroid and reproductive problems. The chemicals pose a special risk to the health of children. The PCB contamination of the Hudson dates back to a 30 year period ending in 1977 during which the General Electric Company (GE) discharged as much as 1.3 million pounds of PCBs directly into the river from their facilities in Hudson Falls and Fort Edward, New York. The dredging project, which would require GE responsibility for cleanup under the Superfund law, would take an estimated five years to complete and is estimated to cost about $460 million.*

This situation has changed since the mid 1990's. Businesses experienced advantages, environmentally and economically, by integrating environmental issues into their strategy planning and by minimizing pollution through prevention at the source. Furthermore targets, action plans and environmental management were built into future planning. Many communities, businesses and governments now have public policies for their commitment to the protection of the environment.

1. For **small and medium sized enterprises** the emphasis is very much on cost savings, although they also benefit from higher revenues and improved market access, especially through environmental products and services.

2. **National companies and multinational corporations** gain benefits in all sustainability agendas, led by cost savings from environmental process improvement.

3. **Foreign multinationals** (headquartered in developed countries) also experience more intangible benefits such as risk reduction and human capital development.

4. **Export-oriented companies** that demonstrate adherence to sustainability standards and management systems benefit from better access to markets and can sometimes apply price premiums to their products.

5. **Companies focused on the domestic market** are more likely to gain from local economic and community development, which strengthens their license to operate and can deliver revenue growth.

In most **geographic regions**, eco-efficiency - cost savings from better environmental management - is the most significant relationship. South Asia appears to be the exception: the strongest evidence of a business case is for higher revenue from local economic growth, and community development leading to improved reputation. These geographic differences are also a function of the different business contexts in these areas.

The conclusion therefore is that accountable government, business and communities must recognise and respond to integrated sustainability issues to demonstrate good corporate governance.

The Messages from Others

"You would probably have a better bottom line if you placed greater value on the resources with which you are entrusted." Jo Anne Di Sano, Director of the United Nations Division for Sustainable Development, 1999.

On Friday, November 8, 2002, appearing before hundreds of investors at the annual meeting of the Securities Industry Association in Boca Raton, Florida, the chairman of the New York Stock Exchange, Richard Grasso, apologized for the breakdown in US corporate governance and transparency that had led to a loss of more than $7 trillion in equity value.

"*In five years, there will be no access to international markets for companies that do not show respect for the environment. It is becoming fundamental to international trade*." Rafael Wong, executive vice president of Reybancorp in Ecuador.

"*We consumers have an ethical obligation to curb our consumption, since it jeopardizes the chances for future generation. Unless we climb down the consumption ladder a few rungs, our grandchildren will inherit a planetary home impoverished by our affluence*." Alan Durning of the Worldwatch Institute.

In May 2002 Exxon-Mobil's failure to articulate a credible climate policy earned it an unprecedented rebuke at its annual general meeting. More than 20% of its shareholders (worth more than $55 billion in share value) voted for a climate-related resolution that management had ferociously opposed.

"*The ultimate purpose of business is not, or should not be, simply to make money. Nor is it merely a system of making and selling things. The promise of business is to increase the general well-being of humankind through service, a creative invention and ethical philosophy. ...If Dupont, Monsanto, and Dow believe they are in the synthetic chemical production business, and cannot change this belief, they and we are in trouble. If they believe they are in business to serve people, to help solve problems, to use and employ the ingenuity of workers to improve the lives of people around them by learning from the nature that gives us life, we have a chance*." Paul Hawken.

Shareholders and the Australian public believe corporate boards and chief executives carry the bulk of responsibility in corporate collapses. The majority of analysts (81%) and executives (76%) believed responsibility lay with a company's board. ("Corporate Reporting – How confident are We?" CPA Australia survey 2003)

"*When the ecological crisis is set within the broader context of the search for peace within society, we can understand better the importance of giving attention to what the earth and its atmosphere are telling us: namely, that there is an order in the Universe which must be respected, and that the human person, endowed with the capability of choosing freely, has a grave responsibility to preserve this order for the well-being of future generations . . .*" John Paul II 1990 World Day of Peace Message

Johannesburg, 4 September 2002: "*This Summit makes sustainable development a reality.*" United Nations Secretary-General Kofi Annan said at a closing press conference in Johannesburg yesterday. "*This Summit will put us on a path that reduces poverty while protecting the environment, a path that works for all peoples, rich and poor, today and tomorrow…The Summit represents a major leap forward in the development of partnerships, with the UN, Governments, business and civil society coming together to increase the pool of resources to tackle global problems on a global scale…* ***We have to go out and take action. This is not the end. It's the beginning***."

The Process of Change

Accountability, governance and sustainability are not limited to any one sector. We expect it in transportation, automobile, and rail; in the water and waste industry; in energy and petroleum; in the electricity and power generation; in forestry, pulp & paper, in steel, chemicals, and mining, in tourism, building construction, and real estate, in manufacturing, agriculture, and food production, in finance and insurance. We find it across government, business and community sectors and behaviours.

To fully embrace the concept of accountable behaviour across the sustainability agenda to demonstrate good governance, for many, change is needed.

A broad social psychological / sociological theory called Diffusion of Innovations (DoI) Theory purports to describe the patterns of adoption, explain the mechanism, and assist in predicting whether and how success can be achieved. It is expressed in Rogers E.M. 'Diffusion of Innovations' The Free Press, New York, originally published in 1962, 3rd Edition 1983.

According to diffusion theory, the **stages** through which the introduction of change occurs are:

1. **knowledge** (exposure to and understanding of its existence);
2. **persuasion** (the forming of a favourable attitude to options available);
3. **decision** (commitment to action);
4. **implementation** (putting it to practice); and
5. **confirmation** (reinforcement based on positive outcomes).

Conclusions

As in life, there are no guarantees. The same applies for the success from improving environmental, social or corporate governance performance. The outcomes are significant when they can be realised, including:

1. licence to operate (economic and social);
2. reduced costs and/or better allocation of funds and resources;
3. increased revenues through business growth;
4. increased security in marketplace positioning;
5. multidimensional understanding of risk for better management practices;
6. enhanced internal and external reputation;
7. informed staff and community (empowerment); and
8. improved access to capital.

Government needs to provide good governance, regulatory certainty, and an appropriate mix of policy tools, including clear and enforceable regulatory standards, and appropriate economic instruments.

Business can include their sustainability, governance and accountability performance as a justification in seeking investor funding.

NGOs can apply appropriate pressure on companies, and by exploring collaboration and new partnerships involving business, governments and other stakeholders to advance accountability, governance and sustainability agendas.

Communities can act on their values - question companies' governance, sustainability and accountability performance, and follow through in their purchasing decisions.

The conclusion therefore is that accountable government, business and communities must recognise and respond to integrated sustainability issues to demonstrate good corporate governance.